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Safeway Inc.

Investing in the Future to Sustain Profitable Growth

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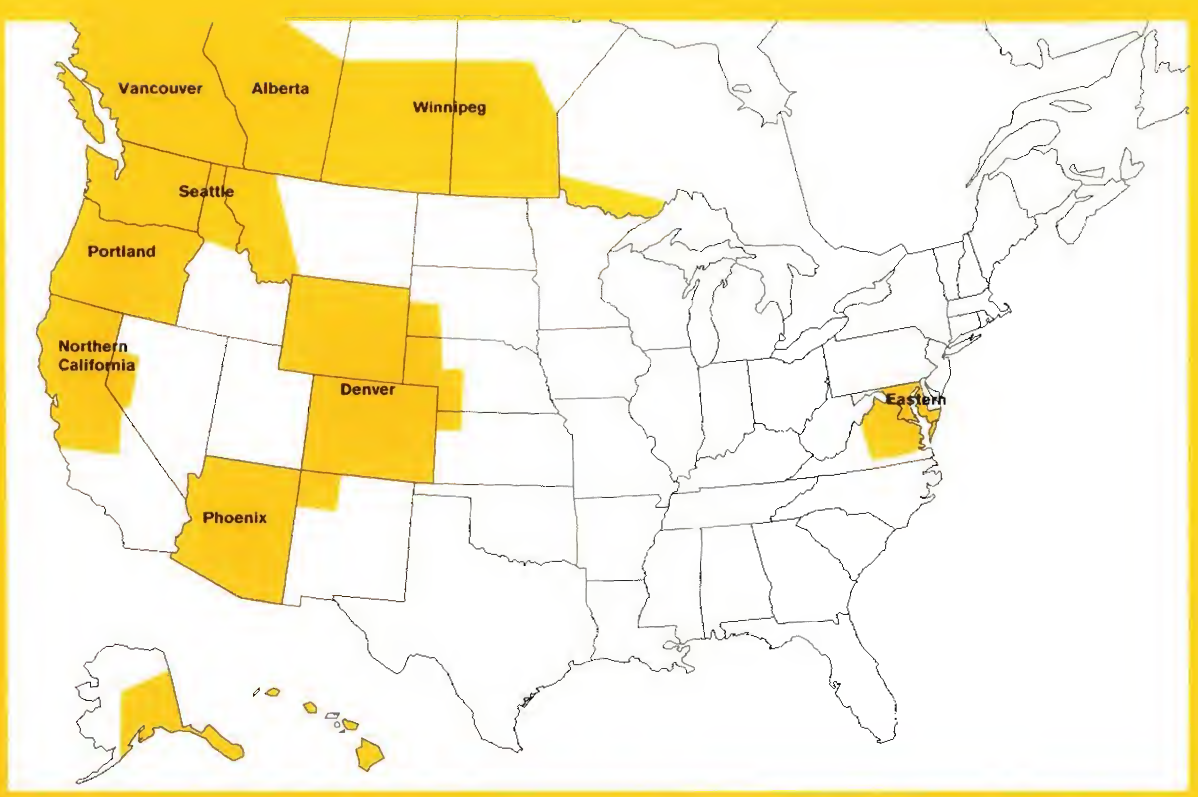
1990 Annual Report



Safeway's retail operations are organized into nine geographic divisions. Each division has its own distribution center for warehouse and trucking operations, as well as a headquarters office to provide merchandising, accounting, data processing and other administrative support.

Safeway Inc. is one of the world's largest food retailers. The company operates approximately 1,100 stores in the Western, Rocky Mountain, Southwestern and Mid-Atlantic regions of the United States and in the four western-most provinces of Canada. These areas include some of the fastest growing markets in North America. To encourage local autonomy in responding to consumer demands within these diverse markets, management of Safeway's retail divisions is highly decentralized.

In support of its retail operations, the company has an extensive network of distribution, manufacturing and food processing facilities.

Safeway also holds a 35% interest in The Vons Companies, Inc., the largest supermarket chain in southern California with more than 300 stores, and a 49% interest in Controladora de Empresas del Noroeste, S.A. de C.V. ("Casa Ley"). Casa Ley operates 21 food/variety multi-department stores, nine wholesale outlets and three clothing stores in western Mexico.

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Highlights

Grocery shopping is more than a necessity – it can be an exciting and helpful part of the way we live.

- A young family celebrates the close of escrow on their first home by buying a cooked, cleaned and cracked Dungeness crab, a fresh loaf of sourdough, and beautiful greens for a salad.
- A working couple dashes into a new Marketplace store, consults briefly with the wine steward, and picks out a special bottle of Chardonnay and bouquet of roses to bring to a friend's birthday party.
- Two roommates stop by China Express for a take-out dinner, select a newly released movie from the video section and head for home.
- A grandmother prepares for a visit from out-of-town grandchildren by calling in a shopping list that includes all the kids' favorites to be delivered to her home from Safeway Express.

Today's shoppers lead complex, busy, demanding lives. Accordingly, Safeway's strategy is to build and maintain market share through stores that distinctly add to the quality of life.

Ambitious plans like these require serious investments of time and capital. In the pages that follow, we highlight some of the specific goals and programs that are making these plans a reality.

UNIVERSITY OF TEXAS AT ARLINGTON
REFERENCE

(dollars in millions)	1990	1989	1988
For the Year:			
Sales	$ 14,873.6	$ 14,324.6	$ 13,612.4
Gross profit	3,976.6	3,689.5	3,435.8
Operating profit	535.3	462.4	398.9
Net income	87.1	2.5	31.2
Capital expenditures	489.6	375.5	312.6
At Year-End:			
Common shares outstanding (in millions)	79.3	67.7	67.7
Retail square feet (in millions)	38.2	37.5	37.4
Number of stores	1,121	1,117	1,144

To Our Stockholders

1990 was a landmark year for Safeway. Despite uncertainties in the economy, we achieved significant growth in operating profit, operating cash flow and net income. We also took two important steps to position our company for continued success in the 1990s and beyond: At the beginning of the year we initiated a five-year, $3.2 billion capital expenditure program to build new stores and continue to extensively renovate many of our existing facilities; and in April, after three and a half years of private ownership, we became a publicly-held company again with the sale of 11.5 million shares of common stock.

Review of Operating Results

Consolidated net income was $87.1 million or 91 cents per share compared with $2.5 million or 3 cents per share in 1989. The significant year-to-year increase resulted primarily from three factors: 1) a sharp rise in operating profits; 2) a substantially higher earnings contribution from our 35% interest in The Vons Companies, Inc.; and 3) an additional fourth-quarter tax expense of $46 million in 1989 relating to a dividend from our Canadian subsidiaries.

Gross margins, aided by new information systems that enable us to merchandise better and purchase product at lower cost, climbed to 26.7% of sales from 25.8% a year earlier. The continuing improvement in gross margins also reflects the increasing mix of business in higher-margin specialty departments made possible by our accelerated capital spending program.

Operating profit, a key performance indicator, rose to $535.3 million or 3.6% of sales from $462.4 million or 3.2% of sales in 1989. Operating profit was substantially higher on a sales base of approximately $15 billion in 1990 than it was on a base of almost $20 billion in 1985, our last full year before the leveraged buyout and subsequent restructuring. "New" Safeway is a smaller but decidedly better performing company.

Operating cash flow – defined here as FIFO earnings before income taxes, interest, depreciation and amortization (FIFO EBITDA) – increased by 16% to 5.9% of sales compared with 5.2% in 1989. This ranked us first among the five highest-volume supermarket chains in the U.S.

The dampening effects of recession have reverberated throughout virtually all sectors of the economy. Food retailing, though historically more resistant than most industries to business downturns, is no exception. Our sales in 1990 were $14.9 billion, an increase of 3.8%. While this gain is consistent with recent trends and appears to be in line with what most of our competitors have experienced, it still was somewhat below expectations.

We are determined to regain our sales momentum. To that end we are adding more expanded delicatessens with Chinese kitchens and a wide assortment of other take-out foods for busy shoppers seeking lower cost alternatives to restaurant meals; we are merchandising our stores more skillfully to reflect our customers' shifting food preparation and consumption patterns; we are monitoring our pricing market-by-market to ensure that we remain fully competitive; and we are placing greater promotional emphasis on low-price items and our extensive, award-winning private label program. We also stand to benefit from the additional, full-year sales volume of several stores that were newly opened or remodeled late in 1990.

New Stores and Support Facilities

As detailed on the following pages, Safeway has embarked upon a five-year, $3.2 billion capital spending program to ensure that our facilities are among the most modern in the industry. This is almost double the amount invested during the preceding five years. What's more, it will be allocated to a store base about half the size we operated prior to the buyout in 1986.

The program's principal focus is on expanding and improving our store system in existing territories. These are attractive, high-growth areas where we already have strong market share positions. During 1990 we opened 30 new stores, extensively remodeled 90 others and closed 26 outmoded ones.

With our strong emphasis on remodels and replacement stores – many of which we build and own ourselves – we are optimistic that our development program will move ahead essentially as planned despite the general slowdown in construction activity. In 1991 we expect to open approximately 35 new stores, complete 90 major remodels and, in our Northern California Division, start building a new 1.8 million square foot distribution center.

New Directors

We are pleased to welcome two new members to the Board of Directors: Paul Hazen, president and chief operating officer of Wells Fargo & Co., and Sam Ginn, chairman and chief executive officer of Pacific Telesis Group. Both men are seasoned, highly respected business and community leaders. We value their wise counsel and look forward to their active participation in the company's affairs.

Lessons from the LBO

The last four years have been an exciting and rewarding period for Safeway. We have consolidated and improved our operations, refined our marketing strategy and laid a strong foundation for future growth. In the process, we also have learned valuable lessons about how to run the business more effectively.

While we have reemerged as a public company, we will continue to act like a private one – that is, to be more like owners than just managers. Specifically, our operating philosophy is to:

- Focus upon enhancing shareholder value over the long term, rather than narrow our sights to only quarterly earnings.
- Evaluate each asset on its own merits and not subsidize underperforming operations.
- Avoid the trap of equating size with success.
- Motivate our managers by giving them a greater stake in the success of the enterprise through broad-based incentive plans and stock options.

Consistent with our strong belief in the value of performance-based compensation, more than 7,000 Safeway employees at various levels are now bonus eligible, and some 3,000 employees have stock options. More than 13% of Safeway's common shares are owned, or are under option to be owned, by our employees.

Outlook

In closing, I would like to thank our employees for their tireless support throughout the four-year post-LBO period. I'm convinced that they, along with our investors, will continue to share in the success they have helped make possible.

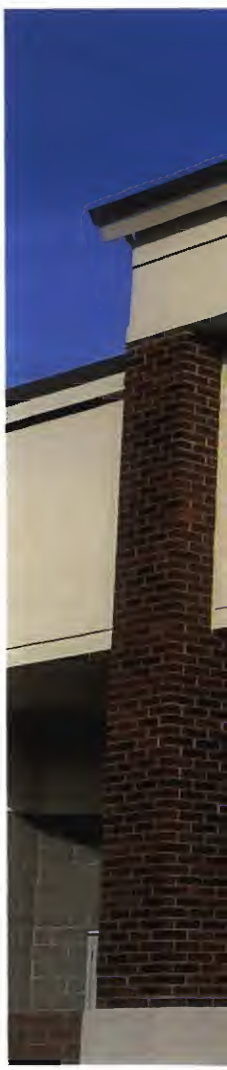
Looking ahead, it is unclear how long, and how deep, the recession will be. To date, our operating areas have been less affected by the downturn than other regions. Of further encouragement, current economic indicators point to reduced energy costs, declining interest rates and lower inflation – all of which should spark a gradual resurgence of consumer confidence. We are well positioned for continued growth and expect 1991 to be another successful year for Safeway.

Peter A. Magowan
Chairman, President and Chief Executive Officer
February 12, 1991

Investing in the Future

Our $3.2 billion capital expenditure program is the key element of a long-term strategy to position Safeway among the industry's best.

In 1990 Safeway initiated an unprecedented five-year, $3.2 billion capital investment program. It provides the cornerstone of our marketing and financial strategy and, we believe, will substantially increase shareholder value by positioning Safeway among the best performers in food retailing. The program's primary goal is to systematically strengthen our store system to serve our customers better while enhancing profitability and establishing a foundation for future growth.



We will be investing the bulk of our capital in retail facilities – building new stores and remodeling existing ones.

About three-fourths of our capital spending will be allocated to new stores and remodels. By the end of 1994, approximately two-thirds of our store system will have been newly built, enlarged or extensively remodeled during the preceding five years. In support of these facilities, we also will be investing in new technology to achieve greater efficiencies in our distribution and private-label manufacturing operations.

We're investing in attractive markets with favorable demographics, markets where we already have strong positions.

We plan to allocate all new spending to existing Safeway territories, where we believe each of our retail divisions commands the number one or number two market share position overall. These are among the fastest growing areas in North America. By concentrating our expenditures in these areas, we can further strengthen our market positions and achieve greater economies of scale in marketing and distribution expenses. In addition, our focus on company-owned properties will give us an advantage in completing construction plans, despite financing constraints a recession may impose on commercial real estate developers. This strategy minimizes risk and offers the best promise of excellent, predictable returns on our investments.

In 1990 Safeway opened 30 new stores and remodeled 90 others. Most of these were adaptations of the "Marketplace" prototype.

Building the New Safeway

Our capital expenditure program establishes the framework for superior operating results and financial performance.

Capital is the engine that will drive our marketing strategy and long-term financial performance. We plan to continue building sales and improving operating margins as more, larger stores come on line with expanded merchandise assortments and additional specialty departments. While satisfying consumers' desire for one-stop shopping convenience, this "enriched" product mix will also favorably affect our return on sales.

We evaluate proposed projects against strict investment criteria, then monitor progress closely.

At Safeway, capital spending is a systematic, highly disciplined process. To ensure that our funds are deployed wisely, targeted pre-tax return-on-investment rates for proposed expenditures are high – generally 25% for new stores and 30% for remodels. Each project is thoroughly analyzed and, if approved, is carefully tracked to measure actual returns against targeted results.

Our incentive compensation plans, among the most comprehensive in food retailing, tie pay to performance.

To further assure that targeted returns are attained, we have designed our incentive compensation plans to incorporate financial performance criteria. For any year in which an operation does not achieve targeted returns on invested capital, covered executives forego a significant part of their potential compensation. Recognizing that the dramatic improvement in Safeway's recent operating results is due largely to linking compensation and stock ownership with performance, we have greatly expanded our incentive plans. More than 7,000 employees – from senior executives to store department managers – are now eligible for bonuses, and approximately 3,000 employees have been granted stock options. We believe these plans are the most extensive, and most effective, in the industry.

Replacement stores and remodels will account for more than half of our five-year, $3.2 billion capital spending program.

Remodels and expansions of existing stores permit the addition of more high-margin specialty departments.

Responding to Changing Consumer Needs

We are redefining "value" by providing our customers with superior quality, selection and service at competitive prices.

Our research tells us a great deal about what consumers like and why they select one store over another. This information has led us to focus our marketing efforts on four key elements. Together they compose what we consider the ultimate combination of total value: superior quality merchandise, particularly in perishable goods; an unparalleled array of products and services; exceptionally courteous, attentive service; and overall price levels that are fully competitive. By constantly refining and improving our execution in these areas, we expect to continue to expand our sales base and improve our operating margins.

With the economic outlook uncertain, consumers have become increasingly sensitive to price.

We believe that quality, selection and service are the primary differentiators in the total value formula, so we strive to be demonstrably superior to our competitors in those areas. At the same time, we realize today's consumer has become more price sensitive in the current economic environment. Accordingly, we are closely monitoring both our pricing and our price image in each market to ensure that we remain fully competitive. We're also emphasizing more low-price items and private label merchandise in our advertising.

Innovation and technology help us build sales and reduce costs to sustain satisfactory margins.

Safeway continues to be an industry leader through innovation and technology. Our new "Marketplace" format, a refined superstore design that uses a storefront motif to highlight each department as a "store within a store," has been very popular with our customers. Safeway Express, a home delivery service recently introduced in selected markets, has also been well received. Among the many technological developments now in use are computer-based programs that help us purchase, distribute and display merchandise to match our customers' desires more effectively. These programs and other efficiencies enable us to be price competitive while maintaining necessary profit margins.

Shoppers can fill prescriptions in a third of our stores. Barely one in 10 Safeway stores had a pharmacy five years ago.

Almost 70% of our stores have full-service bakeries, featuring a tempting array of fancy tortes, decorated cakes and crusty pastries.

The Good Business of Community Involvement

We serve the communities in which we do business with our most valuable assets – the skills, energy and imagination of our employees.

Across our company, there are extraordinary examples of Safeway people who reach out and devote their time, talent and energy to their communities. We support such efforts through our Community Pride program, extending the good work of employees with financial contributions from the company. Exemplifying this commitment to helping others, our employees raised $4.1 million for Easter Seals in 1990. The bulk of this record sum was generated store by store through individually sponsored events such as car washes, root beer float sales and raffles.

Integrating our values with our work is good corporate citizenship and good business.

We're investing in people – from our work with Easter Seals which delivers services to people in the communities where we live and work, to thinking creatively about expanding our work force to include more seniors and people with disabilities. These aren't merely gestures of social responsibility, they're strategic business decisions. In recognition of our "Change for the Hungry" program, an extension of our ongoing support of regional food banks, last year we received the prestigious "C" Flag from the President's Citation Program for Private Sector Initiatives. Safeway was the only organization to have been so honored in each of the six years the program had been in effect.

We work to protect our environment with efforts that save money and resources in both energy and raw materials.

We are not newcomers to the environmental movement. We have been investing time, effort and capital to safeguard the Earth's natural resources ever since we established our first recycling program over 20 years ago. Today, we employ sophisticated energy-saving technologies in all our stores and support facilities. We work with suppliers to find ways to eliminate excessive packaging and improve product safety. Our Environmental Options Program provides information to help consumers select ecologically sensitive products – all as part of our effort to preserve the Earth's beauty and resources for future generations.

Host Pat Boone accepts Safeway's check for $4.1 million during the 1990 national fundraising telethon for Easter Seals.

Seniors are a valuable and growing segment of our work force. They are loyal, highly productive employees.

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The Company in Review

Safeway Inc. is one of the world's largest food retailers, operating more than 1,100 stores in the United States and Canada. U.S. retail operations are located in northern California, Oregon, Washington, and the Rocky Mountain, Southwest and Mid-Atlantic regions. Canadian retail operations are located principally in British Columbia, Alberta, Saskatchewan and Manitoba. These areas include some of the fastest growing markets in North America. Management of the retail operations is highly decentralized to encourage strong local autonomy in responding to consumer demands within the company's diverse markets. In support of these operations, Safeway has an extensive network of distribution, manufacturing and food processing facilities.

In addition to stores operated under the Safeway name, the company has ownership interests in two other retail grocery companies. Safeway holds a 35% interest in The Vons Companies, Inc. ("Vons"), which operates over 300 grocery stores in southern California, and a 49% interest in Controladora de Empresas del Noroeste, S.A. de C.V. ("Casa Ley"), which operates 33 stores in western Mexico.

Safeway Stores, Incorporated ("Predecessor") was founded in 1926 and quickly became one of the world's largest food retailers. In 1986 Predecessor, which was then a publicly-held corporation, was acquired in a leveraged buyout transaction ("LBO") by a corporation formed by the private investment firm of Kohlberg Kravis Roberts & Co. ("KKR"). Since the LBO, Safeway has extensively restructured its operations by, among other things, selling 11 major operations and certain other assets and facilities. Proceeds of approximately $2.4 billion from the sales of these operations were applied to reduce the debt incurred in connection with the LBO. Total debt has declined from $5.8 billion at the time of the LBO to $3.1 billion at year-end 1990. Safeway has serviced its debt with cash from operations since the completion of divestitures in August 1988. In April 1990, the company returned to the public market to sell 11.5 million shares of common stock, listed on the New York Stock Exchange, for net proceeds of approximately $120 million.

Safeway has substantially improved operating results since the LBO. Operating profit was higher in 1990 on sales of approximately $15 billion than in 1985 on sales of almost $20 billion. The company attributes this improvement to (i) a customer-oriented marketing strategy that emphasizes superior quality, selection and service at competitive prices in attractive facilities; (ii) the replacement or remodeling of smaller, older stores to increase store size and add specialty departments; (iii) improved buying practices; (iv) a performance-based compensation program that effectively motivates managers; and (v) realized savings in non-store expense categories. In addition, since 1986 Safeway has reduced excess warehouse replenishment inventory levels through computer-assisted programs and introduced pricing and promotional strategies to become more competitive. The company has improved in-store service at the checkstand area by increasing staff levels and equipping more stores with optical scanner checkout systems.

Stores

To accommodate changing consumer needs and interests and to obtain certain operating efficiencies, Safeway has placed a growing emphasis on the development of superstores, defined

as stores of 35,000 square feet or larger. At year-end 1990, 46% of the company's stores were superstores. At the end of 1990, Safeway's store count was as follows:

	Conventional Stores	Superstores (1)	Total Stores
U.S. Divisions:			
Denver	54	69	123
Eastern	85	62	147
Northern California	154	95	249
Phoenix	26	60	86
Portland	60	42	102
Seattle	91	85	176
Total U. S.	470	413	883
Canadian Divisions:			
Alberta	42	46	88
Vancouver	57	29	86
Winnipeg	34	30	64
Total Canada	133	105	238
Total Stores	603	518	1,121

(1) 35,000 square feet or larger, including 13 Pak 'N Save superwarehouse stores.

Superstores average 43,700 square feet, offer a wide selection of both food and general merchandise and feature additional specialty departments, which generally carry higher average gross margins than traditional grocery items. In October 1988 Safeway introduced its "Marketplace" prototype, a refinement of the superstore that uses a store-front motif to identify and isolate each department as a "store within a store." Speciality departments are showcased in each corner and along the perimeter walls of the store to create a pleasant, boutique-style shopping environment.

Safeway's conventional stores, averaging 25,800 square feet, offer a full selection of food and general merchandise and generally include one or more specialty departments. The conventional store format remains an important part of the company's store program in smaller communities where the superstore format would not be appropriate.

The following table lists the percentages of Safeway stores in continuing operations which had the following specialty departments at year-end 1990 and year-end 1985:

	Number	Percentage of Stores with Specialty Departments					
Store Type	of Stores	Bakery	Deli	Pharmacy	Fresh Fish	Floral	Salad Bar
Conventional	603	40%	64%	13%	29%	54%	44%
Superstore	518	98%	98%	60%	76%	95%	76%
Total, year-end 1990	1,121	67%	80%	35%	51%	73%	59%
Total, year-end 1985	1,247	46%	43%	13%	15%	24%	26%

At year-end 1990, 28% of Safeway's stores were owned rather than leased. The company prefers ownership because it provides control and flexibility with respect to financing terms, remodeling, expansions and closures. Approximately one-third of the leased stores were built by Safeway and then sold and leased back. The remainder (including those in shopping centers) were built by and leased from third-party developers. Management believes that many of its sale and leaseback arrangements, which are generally long-term in nature, provide for rental rates which are below current market rates.

In support of its retail operations, each division generally has one or more administrative offices and warehouse and distribution centers.

Manufacturing and Wholesale Operations

Supply operations are an important part of the company's business. The principal function of supply operations is to manufacture, process and purchase private-label merchandise sold in Safeway stores under such well known and respected brand names as Lucerne, Bel-air, Cragmont and Town House. Approximately 3,000 private-label products are sold in Safeway stores.

Safeway operated the following manufacturing and processing facilities at year-end 1990:

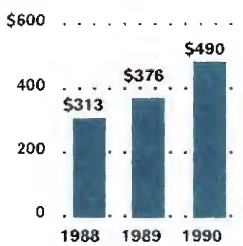
	U.S.	Canada
Milk plants	8	3
Bread baking plants	6	3
Ice cream plants	5	3
Cheese packaging plants	3	1
Soft drink bottling plants	4	–
Other plants	12	8
	38	18

No manufacturing or processing facilities were opened or closed in 1990.

In addition, Safeway operates modern laboratory facilities for quality assurance and research and development in certain of its plants and at its U.S. supply headquarters in Walnut Creek, California.

Safeway's Canadian subsidiary has a wholesale operation, which distributes both national brands and private label products to independent grocery stores and institutional customers.

Capital Expenditures
(In millions)



New Stores and Remodel Projects

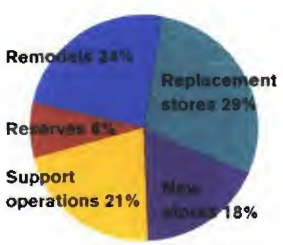
In 1990 Safeway launched a five-year, $3.2 billion capital expenditure program (including new operating lease obligations). During 1990 Safeway opened 30 new stores and completed 90 major remodel projects. Capital expenditures in 1990 were financed primarily with cash from operations, lease obligations, new borrowings (primarily mortgages) and net proceeds of approximately $120 million from the 1990 common stock offering. Capital expenditures in 1991 are expected to exceed $600 million.

The table below reconciles total property additions as reflected in the consolidated financial statements, which includes leases capitalized for accounting purposes and purchases of previously leased properties, to the more broadly defined capital expenditure program (dollars in millions):

	1990	1989	1988
Total property additions per financial statements	$ 426.2	$ 392.6	$ 291.5
Less: Capital lease additions	(3.3)	(12.6)	(6.3)
Purchases of previously leased properties	(23.1)	(94.8)	(28.0)
Plus: Present value of all lease obligations incurred	89.8	90.3	55.4
Total capital expenditures	$ 489.6	$ 375.5	$ 312.6
As a percent of sales	3.3%	2.6%	2.3%

Capital Expenditure Program

Five Years – $3.2 Billion



Approximately one-half of the total capital expenditure program through 1994 will be used for new and replacement stores, one-quarter to remodel and maintain existing stores, and the remainder for support operations, including the replacement of the northern California warehouse partly destroyed by fire in 1988. Safeway expects that 60% of the new stores will be replacements and 40% will be at new locations. The emphasis on store replacement and remodels will increase total retail square footage while maintaining approximately the same store count.

In the last three years, Safeway has opened 84 new stores and remodeled 308 stores.

Investment Decisions

In the last several years, Safeway management has significantly strengthened its program to select and approve new capital investments. This program requires that proposed projects meet targeted pre-tax internal rates of return ("IRR"), which measure the incremental cash flows of proposed projects. To be accepted, new stores must generally project a 25% IRR, and remodels, a 30% IRR. Projects that respond to the increased presence of competitors are sometimes approved on a strategic rather than a financial basis. To date actual results of projects accepted under this program have generally met or exceeded expectations.

Performance Measurement

Operating results have improved in recent years in part due to expanded performance-based compensation plans. These plans measure the performance of each retail division and construction project to ensure expected returns are achieved. Operating results of each retail division are measured against a targeted return on its average net assets (generally measured at market value). Individual construction projects are evaluated for both on-budget completion and performance over several years. Payment of a significant portion of incentive compensation is withheld until predetermined performance levels are maintained for two years. Overall, performance objectives have been exceeded in each of the last three years.

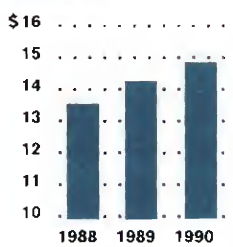
Five Year Summary Financial Information

Safeway Inc. and Subsidiaries

(dollars in millions, except per share amounts)	52 Weeks 1990	52 Weeks 1989	52 Weeks 1988	52 Weeks 1987	17 Weeks 1986	Predecessor 36 Weeks 1986
Results of Operations:						
Sales	$ 14,873.6	$ 14,324.6	$ 13,612.4	$ 18,301.3	$ 6,612.1	$ 13,699.4
Gross profit	$ 3,976.6	$ 3,689.5	$ 3,435.8	$ 4,542.1	$ 1,607.6	$ 3,343.3
Operating and administrative expenses	(3,441.3)	(3,227.1)	(3,110.2)	(4,125.3)	(1,480.3)	(3,057.9)
Gain on divestiture of assets	–	–	73.3	62.5	–	–
Operating profit	535.3	462.4	398.9	479.3	127.3	285.4
Interest expense	(384.1)	(382.8)	(401.2)	(576.4)	(228.7)	(119.0)
Other income, net	43.5	14.4	67.6	35.9	17.0	12.4
Income (loss) before income taxes and cumulative effect of change in accounting	194.7	94.0	65.3	(61.2)	(84.4)	178.8
Income tax expense	(107.6)	(91.5)	(34.1)	(17.1)	(40.0)	(68.7)
Cumulative effect of change in accounting for income taxes	–	–	–	(409.4)	–	–
Net income (loss)	87.1	2.5	31.2	(487.7)	(124.4)	110.1
Dividends on Redeemable Preferred Stock	–	–	(3.6)	(7.7)	(0.7)	–
Net income (loss) to common stockholders	$ 87.1	$ 2.5	$ 27.6	$ (495.4)	$ (125.1)	$ 110.1
Income (loss) per common share and common share equivalent:						
Primary	$ 0.91	$ 0.05	$ 0.38	$ (7.25)	$ (1.91)	$ 1.80
Fully diluted	0.91	0.03	0.38	(7.25)	(1.91)	1.80
Financial Statistics:						
Gross profit margin	26.7%	25.8%	25.2%	24.8%	24.3%	24.4%
Operating profit margin	3.6%	3.2%	2.9%	2.6%	1.9%	2.1%
Additions to property	$ 426.2	$ 392.6	$ 291.5	$ 245.3	$ 174.9	$ 393.0
Depreciation and amortization	276.2	257.8	247.4	360.2	130.0	247.3
Total assets	4,739.1	4,538.0	4,371.7	4,917.5	7,443.9	5,034.9
Total debt and Redeemable Preferred Stock	3,083.6	3,118.6	3,146.9	3,763.1	5,729.1	1,571.1
Stockholders' equity (deficit)	(183.4)	(388.9)	(368.4)	(461.7)	2.9	1,688.9
Current assets per dollar of current liabilities	1.15	0.87	0.95	1.21	0.83	1.23
Other Statistics:						
Employees at period-end	114,500	110,100	107,200	130,900	172,400	174,000
Stores opened during the period	30	33	21	53	28	56
Stores closed or sold during the period	26	60	445	769	68	97
Total stores at period-end	1,121	1,117	1,144	1,568	2,284	2,324
Total retail square footage at period-end (in millions)	38.2	37.5	37.4	50.4	70.4	70.5

Financial Review

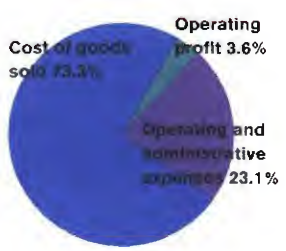
Sales
(in billions)



Results of Operations

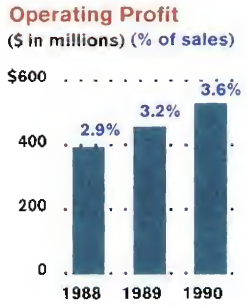
Sales have grown steadily to $14.9 billion in 1990 from $14.3 billion in 1989 and $13.6 billion in 1988 despite increased competition in certain markets and the recent downturn in the U.S. and Canadian economies. The uncertain economy has dampened sales growth throughout the grocery industry and is reflected in Safeway's moderate same store sales (sales of stores operating the entire measurement period in both years) increase of 2.9% in 1990 compared to 5.5% in 1989. Same stores sales increased only 1.7% in the fourth quarter of 1990, and preliminary results indicate that same stores sales increases continued to slow somewhat in early 1991. Management plans to improve sales growth and preserve market share by maintaining a commitment to superior service and product selection at competitive prices. Safeway is working to remain fully price competitive by carefully monitoring prices and emphasizing promotional and private label sales programs. In addition, management believes that the new stores and remodels added under the five-year $3.2 billion capital expenditure program will help Safeway maintain its market share and improve long-term sales growth.

Portions of the Sales Dollar
1990



Gross profit represents the portion of sales revenue remaining after deducting the costs of inventory sold during the period, including purchase and distribution costs. In 1990 gross profit rose to 26.7% of sales, up from 25.8% in 1989 and 25.2% in 1988. This continuing improvement is principally due to significant investments in new inventory information systems and store specialty departments. The new information systems have led to better buying practices, more effective merchandising and improved inventory control, which in turn have held the increase in Safeway's cost of inventory below general inflation rates. Increased sales in the higher-margin specialty departments added in recent years have also contributed to improved gross profit. The LIFO method of valuing certain inventories increased the cost of goods sold by $15.1 million, $15.2 million and $17.1 million in 1990, 1989 and 1988, respectively. These relatively moderate LIFO charges are an additional indication that the increase in the company's cost of inventory is below general inflation rates.

Operating and administrative expenses rose to 23.1% of sales in 1990, up from 22.5% in 1989 and 22.8% in 1988. Increased store employee hours and salary costs, partially offset by reductions in certain other expense categories, contributed to higher operating and administrative expenses in 1990. Average employee hours per store have increased approximately 21% over the last three years, reflecting the increased emphasis on customer service and the addition of labor-intensive specialty departments.

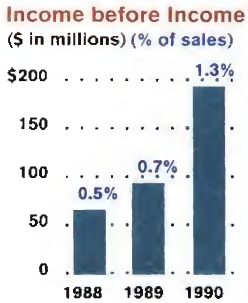


Improved gross profit levels more than offset higher operating and administrative expenses. As a result, operating profit continued to improve to $535.3 million in 1990 from $462.4 million in 1989 and $398.9 million in 1988. When the effect of gain on asset divestitures of $73.3 million in 1988 is eliminated, the upward trend in operating profit is even more pronounced. Operating profit was 3.6% of sales in 1990, 3.2% in 1989 and, excluding the gain on asset divestitures, 2.4% in 1988. The asset divestiture program was completed in 1988. Numerous cost control measures have been implemented over the last three years, resulting in lower costs or reduced rates of increase in various expense categories. Safeway believes that its capital expenditure program will contribute to these favorable trends in the years to come.

The effect of higher interest rates on Canadian borrowings during the third and fourth quarters of 1990 was offset by lower average borrowings throughout 1990, causing interest expense to rise only slightly to $384.1 million in 1990 from $382.8 million in 1989. The decrease from $401.2 million in 1988 resulted from the reduction of debt in 1988 with proceeds from asset divestitures.

The largest components of other income are equity in the earnings of unconsolidated affiliates (primarily Vons and Casa Ley) and interest income. Interest income was $14.1 million in 1990 compared to $11.8 million in 1989 and $55.3 million in 1988. Interest income in 1988 included $26.6 million accrued on the present value of net assets held for sale at year-end 1987.

In 1990, income from equity in earnings of unconsolidated affiliates, recorded on a one-quarter delay basis, was $25.5 million compared to losses of $4.0 million and $4.5 million in 1989 and 1988, respectively. This improvement reflects income from Safeway's 35% equity investment in Vons of $18.3 million in 1990 compared to losses of $8.6 million and $8.7 million in 1989 and 1988, respectively. According to Vons' December 31, 1989 Form 10-K and most recent Form 10-Q, one-time costs associated with the integration of the former Safeway southern California operations acquired by Vons in 1988 were insignificant in 1990 but reduced operating profit by $16.1 million in 1989 and $11.9 million in 1988. Also, Vons' 1990 net income included a $20.5 million reduction of income tax expense from the utilization of net operating loss carryforwards. For financial statement purposes Vons has $65.9 million of net operating loss carryforwards which they can use to reduce future taxable income. One-time costs and overall operating inefficiencies associated with the integration of former Safeway operations in 1989 and 1988 and the gain from the utilization of net operating loss carryforwards in 1990 should be considered when comparing Vons' 1990 net income to prior years.



In the fourth quarter of 1989 the company recognized $46 million in withholding taxes on undistributed earnings of its Canadian subsidiaries which were previously considered to be permanently reinvested. The company will continue to record withholding taxes on earnings of its Canadian subsidiaries. The 1989 expense was recognized in anticipation of the 1990 dividend of $460 million from the Canadian subsidiaries to the U.S. parent, funded largely by borrowings in Canada. The dividend and related debt restructuring are providing long-term tax benefits. Although the interest rates on borrowings in Canada are higher than in the U.S., the anticipated long-term tax benefits are expected to exceed the increased interest expense.

Net income was $87.1 million in 1990, $2.5 million in 1989 and $31.2 million in 1988. Net income for 1989 and 1988 does not reflect the favorable trend in operating results achieved over the last three years primarily because of two nonrecurring items: the $46 million income tax expense in 1989 on Canadian earnings distributed in 1990 and the $48.4 million after-tax gain on asset divestitures in 1988.

Liquidity and Financial Resources

Cash from operations supplemented by credit available under the Bank Agreements are expected to be Safeway's primary sources of liquidity over the next five years.

FIFO earnings before taxes, interest, depreciation and amortization ("FIFO EBITDA") has increased over the last three years as follows (dollars in millions):

	1990	1989	1988
Income (loss) before income taxes and gain on divestiture of assets	$ 194.7	$ 94.0	$ (8.0)
Interest expense	384.1	382.8	401.2
Depreciation and amortization	276.2	257.8	247.4
LIFO charge	15.1	15.2	17.1
FIFO EBITDA	$ 870.1	$ 749.8	$ 657.7
As a percent of sales	5.85%	5.23%	4.83%

This analysis assists in evaluating the company's ability to service its debt as well as facilitating the comparison of Safeway's results of operations with those of companies having divergent capital structures.

In June 1990 Safeway finalized a restructuring of its Bank Agreements to make available to the Canadian subsidiaries up to $475 million in long-term borrowings (U.S. dollar equivalent). At that time, the Canadian subsidiaries borrowed approximately $410 million and completed the dividend of $460 million of accumulated Canadian earnings to the U.S. parent. Net proceeds from the dividend were applied toward reducing short-term borrowings and increasing short-term investments in the U.S. At year-end 1990, the company had unused borrowing capacity of $390 million under the Bank Agreements. Management believes that this is adequate to meet Safeway's liquidity requirements.

Annual maturities of notes and debentures include $423 million under the Working Capital Credit Agreement in 1993 and $250 million sinking fund requirements in 1994 and 1995 on the 11.75% Senior Subordinated Notes. Annual maturities over the next five years are as follows (in millions):

1991	$ 58.1
1992	61.8
1993	495.8
1994	391.1
1995	330.1
	$ 1,336.9

Safeway intends to service its debt maturities over the next five years primarily with cash from operations. It is anticipated that the maturities under the Working Capital Credit Agreement will be extended on an ongoing basis. As a result of additional borrowings, which are expected to consist primarily of mortgages and other indebtedness incurred to partially fund the company's capital expenditure program, Safeway's long-term indebtedness will generally remain at current levels over the next five years.

The Bank Agreements and the indentures related to the Notes and the Debentures contain convenants which restrict management's discretion with respect to certain business matters, including the ability of the company to (i) pay dividends, (ii) acquire company stock, options or warrants, and (iii) retire subordinated debt. These convenants are described in the notes to the consolidated financial statements.

At year-end 1990 working capital was comprised of $1.6 billion of current assets and $1.4 billion of current liabilities. Normal operating fluctuations in these substantial balances can result in significant changes to the cash flow from operations reflected in the consolidated statements of cash flows that are not necessarily indicative of long-term operating trends. Aside from the need to maintain merchandise inventories, there are no unusual industry practices or requirements relating to working capital items.

As of year-end 1990 the company had negative stockholders' equity of $183.4 million. This deficit is the net result of a number of factors including equity capitalization from the LBO and the initial public offering as well as net income and losses since the LBO. However, the largest factor leading to the deficit was a $409 million expense in 1987 from a change in accounting when the company adopted Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes".

Interest Rates

At year-end 1990 the company had debt subject to interest rate changes of $427 million, principally in Canada. In order to reduce exposure to increasing interest rates, Safeway in 1990 entered into two interest rate collar agreements totaling $129 million. The agreements limit interest rates to between approximately 10% and 15% and expire in 1992.

Capital Expenditures

In 1991, the company expects to spend in excess of $600 million of its previously announced $3.2 billion capital expenditure program. This will include approximately 35 new stores, 90 major remodel projects and, in the Northern California Division, commencing construction of a 1.8 million square foot distribution center. The capital expenditures program will continue to be financed primarily with cash from operations, supplemented by lease obligations and new borrowings (primarily mortgages).

While the discretion of the management of Safeway with respect to certain business matters is limited by covenants contained in the Bank Agreements and the indentures related to the Notes and the Debentures, management believes that those covenants will permit sufficient operating and financing flexibility to carry out its capital expenditure program.

Inflation

In recent years, the impact of inflation on Safeway's operating results has been moderate, reflecting generally lower rates of inflation in the economy. Higher inflation in the latter half of 1990 has not significantly impacted operating results. While there is no assurance that the company's business will not be affected by inflation in the future, Safeway does not expect inflation at current rates to materially impact operating results.

Consolidated Statements of Income

Safeway Inc. and Subsidiaries

(in millions, except per share amounts)	1990	1989	1988
Sales	$ 14,873.6	$ 14,324.6	$ 13,612.4
Cost of goods sold	(10,897.0)	(10,635.1)	(10,176.6)
Gross profit	3,976.6	3,689.5	3,435.8
Operating and administrative expenses	(3,441.3)	(3,227.1)	(3,110.2)
Gain on divestiture of assets	–	–	73.3
Operating profit	535.3	462.4	398.9
Interest expense	(384.1)	(382.8)	(401.2)
Other income, net	43.5	14.4	67.6
Income before income taxes	194.7	94.0	65.3
Income tax expense	(107.6)	(91.5)	(34.1)
Net income	87.1	2.5	31.2
Dividends on Redeemable Preferred Stock	–	–	(3.6)
Net income to common stockholders	$ 87.1	$ 2.5	$ 27.6
Income per common share and common share equivalent:			
Primary	$ 0.91	$ 0.05	$ 0.38
Fully diluted	$ 0.91	$ 0.03	$ 0.38
Weighted average common shares and common share equivalents:			
Primary	96.0	79.6	78.7
Fully diluted	96.0	89.4	78.7

See accompanying notes to the consolidated financial statements.

Consolidated Balance Sheets

Safeway Inc. and Subsidiaries

(in millions, except per share amounts)	Year-end 1990	1989
Assets		
Current assets:		
Cash and equivalents	$ 150.6	$ 123.2
Receivables	141.1	141.3
Merchandise inventories, net of LIFO reserve of $56.8 and $41.7, respectively	1,208.1	1,167.7
Prepaid expenses and other	70.6	56.2
Income taxes receivable	12.2	–
Total current assets	1,582.6	1,488.4
Property:		
Land	288.7	240.8
Buildings	624.3	537.1
Leasehold improvements	769.1	717.2
Fixtures and equipment	1,273.3	1,060.1
Property under capital leases	331.9	341.2
	3,287.3	2,896.4
Less accumulated depreciation and amortization	992.0	742.8
Total property, net	2,295.3	2,153.6
Goodwill, net of amortization of $54.9 and $44.5, respectively	379.6	390.0
Prepaid pension costs	304.6	303.7
Other assets	177.0	202.3
Total assets	$ 4,739.1	$ 4,538.0

	Year-end	
	1990	1989
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current maturities of notes and debentures	$ 58.1	$ 398.0
Current obligations under capital leases	21.0	21.7
Accounts payable	843.1	776.9
Accrued salaries and wages	173.5	173.4
Other accrued liabilities	284.0	259.1
Income taxes payable	–	74.2
Total current liabilities	1,379.7	1,703.3
Long-term debt:		
Notes and debentures	2,761.4	2,427.3
Obligations under capital leases	243.1	271.6
Total long-term debt	3,004.5	2,698.9
Deferred income taxes	328.6	319.3
Accrued claims and other liabilities	209.7	205.4
Total liabilities	4,922.5	4,926.9
Commitments and contingencies		
Stockholders' deficit:		
Common stock: par value $.01 per share; 300 shares authorized; 79.3 and 67.7 shares outstanding, respectively	0.8	0.7
Additional paid-in capital	258.5	138.4
Subscriptions receivable	(0.3)	(0.6)
Cumulative translation adjustments	60.9	63.0
Accumulated deficit	(503.3)	(590.4)
Total stockholders' deficit	(183.4)	(388.9)
Total liabilities and stockholders' deficit	$ 4,739.1	$ 4,538.0

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

Safeway Inc. and Subsidiaries

(in millions)	1990	1989	1988
Cash Flow from Operations:			
Net income	$ 87.1	$ 2.5	$ 31.2
Reconciliation to net cash flow from operations:			
Depreciation and amortization	276.2	257.8	247.4
Amortization of deferred finance costs	13.5	13.2	16.0
Deferred income taxes	(35.6)	11.5	(38.3)
LIFO expense	15.1	15.2	17.1
Noncash interest income, net	–	–	(21.5)
Equity in undistributed losses (earnings) of affiliates	(25.5)	4.0	4.5
Net pension income	(0.9)	(6.5)	(8.7)
Increase in accrued claims and other liabilities	3.6	49.1	20.9
Loss (gain) on property retirements	24.7	(1.2)	(82.8)
Changes in working capital items:			
Receivables	0.2	32.8	(34.2)
Inventories at FIFO cost	(55.2)	(65.6)	(57.0)
Prepaid expenses and other current assets	(1.4)	(13.8)	16.9
Payables and accruals	74.4	114.6	55.4
Income taxes	(40.0)	19.4	(16.7)
Net cash flow from operations	336.2	433.0	150.2
Cash Flow from Investing Activities:			
Cash paid for property additions	(422.1)	(365.3)	(257.6)
Proceeds from sale of property and operations	45.9	19.7	750.0
Other	(13.5)	5.4	(8.4)
Net cash flow from (used by) investing activities	(389.7)	(340.2)	484.0

	1990	1989	1988
Cash Flow from Financing Activities:			
Additions to short-term borrowings	$ 5.3	$ 133.7	$ 379.9
Payments on short-term borrowings	(383.9)	(227.2)	(117.2)
Additions to long-term borrowings	450.3	219.1	173.0
Payments on long-term borrowings	(108.8)	(195.2)	(1,023.2)
Net proceeds from sale of common stock	120.5	0.9	4.8
Redemption of Redeemable Preferred Stock and cash dividends	–	–	(57.1)
Other	(0.9)	–	–
Net cash flow from (used by) financing activities	82.5	(68.7)	(639.8)
Effects of changes in exchange rates on cash	(1.6)	2.1	5.5
Increase (decrease) in cash and equivalents	27.4	26.2	(0.1)
Cash and Equivalents:			
Beginning of year	123.2	97.0	97.1
End of year	$ 150.6	$ 123.2	$ 97.0
Other Cash Flow Information:			
Cash payments during the year for:			
Interest	$ 374.5	$ 376.8	$ 403.3
Income taxes (net of refunds)	183.2	61.4	91.5
Noncash Investing and Financing Activities:			
Mortgage notes assumed in property acquisitions	0.8	14.7	27.6
Capital leases obligations entered into	3.3	12.6	6.3
Capital lease assets retired, net of accumulated amortization	5.5	1.9	10.9
Capital lease obligations retired	4.8	9.4	24.9
Redeemable Preferred Stock issued in lieu of cash dividend payments	–	–	1.1
Noncash proceeds from sale of assets – Vons common stock	–	–	83.1

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Stockholders' Equity (Deficit)

Safeway Inc. and Subsidiaries

(in millions)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Subscriptions Receivable	Cumulative Translation Adjustments	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance, year-end 1987	67.6	$ 0.7	$ 136.7	$ (4.4)	$ 25.8	$ (620.5)	$ (461.7)
Options exercised	0.2	–	0.4	–	–	–	0.4
Common stock reacquired	(0.1)	–	(0.3)	0.2	–	–	(0.1)
Amounts received on issuance of options	–	–	0.9	(0.2)	–	–	0.7
Cash received on Subscriptions Receivable	–	–	–	3.6	–	–	3.6
Net income	–	–	–	–	–	31.2	31.2
Dividends and redemption premium on Redeemable Preferred Stock	–	–	–	–	–	(3.6)	(3.6)
Translation adjustments	–	–	–	–	61.1	–	61.1
Balance, year-end 1988	67.7	0.7	137.7	(0.8)	86.9	(592.9)	(368.4)
Common stock reacquired	–	–	(0.1)	0.1	–	–	–
Amounts received on issuance of options	–	–	0.8	(0.1)	–	–	0.7
Cash received on Subscriptions Receivable	–	–	–	0.2	–	–	0.2
Net income	–	–	–	–	–	2.5	2.5
Translation adjustments	–	–	–	–	(23.9)	–	(23.9)
Balance, year-end 1989	67.7	0.7	138.4	(0.6)	63.0	(590.4)	(388.9)
Public Stock Offering	11.5	0.1	119.7	–	–	–	119.8
Options exercised	0.1	–	0.2	–	–	–	0.2
Amounts received on issuance of options	–	–	0.1	–	–	–	0.1
Warrants exercised	–	–	0.1	–	–	–	0.1
Cash received on Subscriptions Receivable	–	–	–	0.3	–	–	0.3
Net income	–	–	–	–	–	87.1	87.1
Translation adjustments	–	–	–	–	(2.1)	–	(2.1)
Balance, year-end 1990	79.3	$ 0.8	$ 258.5	$ (0.3)	$ 60.9	$ (503.3)	$ (183.4)

See accompanying notes to the consolidated financial statements.

Note A – Acquisition and Basis of Presentation

Safeway Inc., a Delaware corporation, and subsidiaries ("Safeway" or the "Company") were formed by the private investment firm of Kohlberg Kravis Roberts & Co. ("KKR") to effect the acquisition (the "Acquisition") of Safeway Stores, Incorporated, a Maryland corporation, and subsidiaries, ("Predecessor"). The Company obtained control of Predecessor in August 1986 by acquiring approximately 73% of Predecessor's common stock for cash of $3.1 billion. The Company acquired the remaining outstanding common stock of Predecessor in November 1986 by converting each remaining share into rights to receive (i) Junior Subordinated Debentures due 2006, and (ii) warrants to purchase shares of the Company's common stock (the "Merger Warrants").

The Acquisition was accounted for as a purchase and, accordingly, at the date of the Acquisition (September 6, 1986 for financial reporting purposes), the Company recorded Predecessor's assets and liabilities at their fair values.

Note B – Significant Accounting Policies

Fiscal Year

The fiscal year of the Company ends on the Saturday nearest December 31.

Basis of Consolidation

The consolidated financial statements include the Company and all significant subsidiaries. All significant intercompany transactions have been eliminated in consolidation. Investments in affiliates which are not majority owned are reported in the consolidated financial statements using the equity method.

Translation of Foreign Currencies

Assets and liabilities of the Company's Canadian subsidiaries are translated into U.S. dollars at year-end rates of exchange, and income and expenses are translated at average rates during the year. Cumulative translation adjustments reflecting the effect of the movement in exchange rates during the year are shown net of applicable income taxes in a separate component of stockholders' equity.

Merchandise Inventories

At year-end 1990 and 1989, merchandise inventory of $658 million and $629 million, respectively, was valued at the lower of cost on a last-in, first-out ("LIFO") basis or market value. Such LIFO inventory had a replacement or current cost of $715 million and $671 million at year-end 1990 and 1989, respectively. The remaining inventory is valued at the lower of cost on a first-in, first-out ("FIFO") basis or market value. FIFO cost of inventory approximates replacement or current cost. Inventory on a FIFO basis includes meat and produce in the United States, inventory of U.S. supply operations, and all inventories of the Canadian subsidiaries.

Note B – Significant Accounting Policies *(continued)*

Application of the LIFO method resulted in increases in cost of goods sold of $15.1 million in 1990, $15.2 million in 1989 and $17.1 million in 1988. Liquidations of LIFO layers during the three years reported did not have a significant effect on the results of operations.

The LIFO charge to cost of goods sold for the first 36 weeks of each year is based upon estimated annual inflation ("LIFO Indices"). Actual LIFO Indices are calculated during the fourth quarter of the year based upon a statistical sampling of inventories. Accordingly, fourth-quarter pre-tax earnings were increased by $6.7 million and $3.7 million in 1990 and 1989 and decreased by $1.0 million in 1988.

Property and Depreciation

Property is stated at cost. Depreciation expense on buildings and equipment is computed on the straight-line method using the following lives:

Stores and other buildings	10 - 30 years
Fixtures and equipment	2 - 14 years

Property under capital leases is amortized on the straight-line method over the remaining terms of the leases. Leasehold improvements include buildings constructed on leased land, improvements to leased buildings and the difference between the cost and fair value of acquired leases. Leasehold improvements are amortized on the straight-line method over the shorter of the remaining terms of the lease or the estimated useful lives of the assets.

Goodwill

Goodwill is amortized on a straight-line basis over 40 years. Goodwill amortization was $10.5 million in both 1990 and 1989 and $10.2 million in 1988. Fluctuating translation rates on goodwill of Canadian subsidiaries account for the minor differences in amortization.

Closed Store Expense

Upon the decision to close a store, the Company accrues estimated future losses, which include lease payments and other costs of holding the facility, net of estimated future income.

Pre-opening Costs

Costs related to opening new stores are charged to income upon opening of the store.

Self-insurance

The Company is primarily self-insured for workers' compensation, automobile and general liability costs. The self-insurance claim liability is actuarially determined based on claims filed and an estimate of claims incurred but not yet reported. The present value of such claims is accrued using an 8% discount rate. The current portion of the liabilities of $68 million and $62 million at year-end 1990 and 1989, respectively, is included in other accrued liabilities in the consolidated balance sheets. The noncurrent portion of $125 million and $149 million in 1990 and 1989, respectively, is included in accrued claims and other liabilities. The undiscounted liability was $252 million and $261 million at year-end 1990 and 1989, respectively.

Income Taxes

The Company provides for income taxes in accordance with Statement of Financial Accounting Standards No. 96 "Accounting For Income Taxes" (SFAS 96). Under SFAS 96, the Company provides a deferred tax expense or benefit equal to the change in the deferred tax liability during the year. Deferred tax liabilities represent net taxes payable in future years resulting from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated balance sheets. Temporary differences consist primarily of property and prepaid pension costs. Deferred tax liabilities are measured at the tax rate expected to be in effect when the taxes from temporary differences are paid, based on current tax law.

Income Per Common Share and Common Share Equivalent

Income per common share and common share equivalent is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period plus the dilutive effect of stock options and warrants, as determined by the treasury stock method.

Statement of Cash Flows

Short-term investments with original maturities of less than three months are considered to be cash equivalents.

Note C – Sale of Assets

Subsequent to the 1986 Acquisition, the Company sold certain of its supermarket operations and other facilities no longer used in its grocery business. The proceeds from these asset sales were used to reduce borrowings under the Bank Credit Agreement.

In 1988 the Company sold operations in Houston and southern California. Net cash proceeds from 1988 asset sales totaled $750 million, including proceeds on operations sold in 1987 with the transactions being finalized in 1988. In addition, the Company received 30% of the common stock of The Vons Companies, Inc. ("Vons"), valued at $83.1 million at the date of sale, as part of the proceeds from the sale of the southern California operations. Asset divestitures resulted in a pre-tax gain of $73.3 million in 1988 ($48.4 million after-tax). The asset divestiture program was completed upon the closure of the southern California transaction in August 1988.

Note D – Financing

Notes and debentures were comprised of the following at year-end (in millions):

	1990	1989
Bank Credit Agreement, secured		$ 50.0
Working Capital Credit Agreement, secured	$ 423.0	43.0
Commercial paper and other bank borrowings, unsecured	–	278.1
11.75% Senior Subordinated Notes due 1996, secured	750.0	750.0
12% Subordinated Debentures due 1998, secured	250.0	250.0
Junior Subordinated Debentures due 2006, unsecured	565.4	565.4
Mortgage notes payable, secured	533.0	510.2
Other notes payable, unsecured	298.1	378.6
	2,819.5	2,825.3
Less current maturities	58.1	398.0
Long-term portion	$ 2,761.4	$ 2,427.3

Bank Credit Agreement and Working Capital Credit Agreement

Following the Acquisition in 1986, the Company had available bank credit lines up to $3.85 billion including $3.5 billion under the Bank Credit Agreement and $350 million under the Working Capital Credit Agreement (together the "Agreements" or "Bank Agreements"). As Safeway's needs for bank financing have declined, the Company has worked with the banks to reduce the levels of available credit. In June 1990 the Company restructured the Agreements to allow the Company to borrow up to $525 million under the Bank Credit Agreement and the Company or its Canadian subsidiaries to borrow up to $475 million (U.S. dollar equivalent) under the Working Capital Credit Agreement. At the time of the restructuring the Canadian subsidiaries borrowed approximately $410 million and repatriated $460 million to the U.S. parent. Net proceeds from the dividend were applied toward reducing short-term borrowings and increasing short-term investments in the U.S. One half of the amount outstanding in June 1993 under the Bank Credit Agreement is then due and the remainder is due in June 1994. Amounts borrowed under the Working Capital Credit Agreement are due in June 1993.

Domestic borrowings under the Agreements, as amended, bear interest at one of the following rates selected by the Company: (i) the prime rate, (ii) a rate based on certificates of deposit rates plus 1% or (iii) the rate at which Eurodollar deposits are offered to first class banks in the Eurodollar market by the Banks plus 0.75%. Canadian borrowings denominated in U.S. dollars under the Working Capital Credit Agreement bear interest at one of the following rates selected by the Company: (i) the Canadian base rate, or (ii) the Canadian Eurodollar rate plus 0.75%. Canadian borrowings denominated in Canadian dollars bear interest at the Canadian prime rate. The Company pays an annual commitment fee of 0.375% on the unused portion of borrowings available under the Agreements. The average interest rates on borrowings under the Bank Credit Agreement were 8.7% during 1990, 10.9% during 1989 and 8.9% during 1988. There were no outstanding borrowings under the Bank Credit Agreement at year-end 1990. The average interest rates on borrowings under the Working Capital Credit Agreement rose to 13.9% during 1990 from 10.2% and 9.2% during 1989 and 1988, respectively. This increase reflects higher rates on Canadian borrowings which were outstanding during the third and fourth quarters of 1990. The weighted average interest rate on borrowings under the Working Capital Credit Agreement at year-end 1990 was 13.0%.

The Agreements restrict, among other things, payments by the Company (i) of dividends on any class of stock (other than dividends paid through issuance of additional shares of that class of stock), (ii) to acquire shares of any class of stock of the Company, (iii) of any debt which is subordinate to the Bank Credit Agreement, and (iv) to acquire any outstanding warrants, options or other rights to acquire shares of any class of stock of the Company, other than those held by certain Company officers.

Other provisions of the Agreements limit certain acts of the Company, including the creation of liens, incurring obligations under leases in excess of specified levels, incurring capital expenditures in excess of specified amounts and entering into certain business activities, investments and guarantees. The Agreements also limit the amount of indebtedness that the Company can incur. The Company is also required to meet certain financial tests which pertain to its ratio of debt to equity and its ability to generate adequate cash to meet required payments.

Indebtedness under the Agreements is secured by the pledge of certain assets of the Company and certain assets and stock of certain subsidiaries, and is also guaranteed by certain subsidiaries.

Subordinated Indebtedness

The Company has issued subordinated indebtedness as described below:

11.75% Senior Subordinated Notes due 1996, $750 million aggregate principal amount (the "Notes"), sinking fund requirement of $250 million principal amount in November 1994 and 1995. The Notes are currently redeemable at 105.875% of par, declining ratably to par in 1994.

12% Subordinated Debentures due 1998, $250 million aggregate principal amount (the "Debentures"), sinking fund requirement of $83.3 million principal amount in November 1996 and 1997. Beginning November 15, 1991, the Debentures are redeemable at 106.0% of par, declining ratably to par in 1996.

Junior Subordinated Debentures due 2006, $565 million outstanding at year-end 1990, bear interest at 14.5% (15% before November 24, 1988). Junior Subordinated Debentures are not redeemable until November 24, 1991 and thereafter are redeemable at 102.9% of par, declining ratably to par in 1993. Through December 1, 1991, the Company has the option of making interest payments by the issuance of additional Junior Subordinated Debentures in lieu of cash.

The Notes are subordinated in right of liquidation payment to the Company's borrowings under the Bank Credit Agreement and Working Capital Credit Agreement and the Company's secured debt and mortgage notes payable (the "Senior Debt"). In addition to being subordinate to the Senior Debt, the Debentures are also subordinate to the Notes. The Junior Subordinated Debentures are subordinate to the Senior Debt, the Notes and the Debentures.

The Notes and Debentures are secured by the pledge of certain assets of the Company and stock of certain first tier subsidiaries and have also been guaranteed by the Company's first tier subsidiaries, Safeway U.S. Holdings, Inc., Safeway Canada Holdings, Inc., and Safeway Australia Holdings, Inc. (collectively the "Subsidiary Guarantors").

Note D – Financing *(continued)*

The Indentures pursuant to which the Notes and Debentures were issued restrict, among other things, payments by the Company (i) of dividends on any class of stock (other than dividends paid through issuance of additional shares of that class of stock), (ii) to acquire shares of any class of stock of the Company, (iii) of any debt which is subordinate to the Notes and the Debentures (other than nonvoluntary prepayments or redemptions, and redemption of Junior Subordinated Debentures under certain circumstances), and (iv) to acquire any outstanding warrants, options or other rights to acquire shares of any class of stock of the Company, other than those held by certain Company officers. The Indentures also contain provisions which limit the amount of additional debt that the Company may incur.

Mortgage Notes Payable

The Mortgage Notes Payable at year-end 1990 are secured by properties with a net book value of approximately $484 million, have remaining terms ranging from 1 to 19 years and bear interest at 5% to 15%.

Other Notes Payable

Other notes payable have remaining terms ranging from 1 to 21 years and bear interest at rates from 8% to 13%.

Scheduled maturities of debt

Annual maturities of notes and debentures are as follows (in millions):

1991	$ 58.1
1992	61.8
1993	495.8
1994	391.1
1995	330.1
Thereafter	1,482.6
	$ 2,819.5

Maturities in 1993 include $423 million under the Working Capital Credit Agreement. Maturities in 1994 and 1995 include the $250 million sinking fund requirements due on the Senior Subordinated Notes.

Short-term Indebtedness

Current maturities of notes and debentures were comprised of the following at year-end (in millions):

	1990	1989
Working Capital Credit Agreement		$ 43.0
Mortgage notes payable	$ 45.7	37.9
Commercial paper and other bank borrowings	–	278.1
Other notes payable	12.4	39.0
	$ 58.1	$ 398.0

Letters of Credit

The Company had letters of credit of $339.5 million outstanding at year-end 1990 of which $187.0 million were issued under the Bank Credit Agreement. The letters of credit are maintained primarily to back the Company's self-insurance program and to support performance, payment, deposit or surety obligations of the Company. The Company pays commitment fees ranging from 0.75% to 1% on the outstanding portion of the letters of credit.

Note E – Lease Obligations

A majority of the premises that the Company occupies are leased. The Company had approximately 1,300 leases at year-end 1990, including approximately 350 which are capitalized for financial reporting purposes.

Many leases have renewal options, some with terms and conditions similar to the original lease, others with reduced rental rates during the option periods. Certain of these leases contain options to purchase the property at amounts that approximate fair market value.

As of year-end 1990, future minimum rental payments applicable to noncancelable capital and operating leases with remaining terms in excess of one year were as follows (in millions):

	Capital Leases	Operating Leases
1991	$ 48.5	$ 126.2
1992	47.6	123.9
1993	46.3	118.5
1994	44.0	115.0
1995	41.9	110.0
Thereafter	249.6	1,032.9
Total minimum lease payments	477.9	$ 1,626.5
Less amounts representing interest	213.8	
Present value of net minimum lease payments	264.1	
Less current obligations	21.0	
Long-term obligations	$ 243.1	

Future minimum rental payments under noncancelable capital and operating lease agreements have not been reduced by minimum sublease rental income of approximately $190 million.

Amortization expense for property under capital leases was $26.0 million in 1990, $27.3 million 1989 and $32.4 million in 1988. Accumulated amortization of property under capital leases was $115.8 million and $95.2 million at year-end 1990 and 1989, respectively.

Note E – Lease Obligations *(continued)*

The following schedule shows the composition of total rental expense for all operating leases (in millions). In general, contingent rents are based on individual store sales.

	1990	1989	1988
Property leases:			
Minimum rentals	$ 120.6	$ 120.7	$ 120.6
Contingent rentals	8.8	5.9	7.5
Less rentals from subleases	(24.3)	(15.0)	(13.6)
	105.1	111.6	114.5
Equipment leases	26.6	19.9	23.8
	$ 131.7	$ 131.5	$ 138.3

Note F – Interest Expense

Interest expense consisted of the following (in millions):

	1990	1989	1988
Bank Credit Agreement and Working Capital Credit Agreement	$ 33.0	$ 9.9	$ 54.8
Commercial paper and other bank borrowings	16.9	35.8	22.4
11.75% Senior Subordinated Notes	88.1	88.1	88.1
12% Subordinated Debentures	30.0	30.0	30.0
Junior Subordinated Debentures	82.0	82.0	82.4
Mortgage notes payable	60.7	52.5	46.9
Obligations under capital leases	28.1	29.1	32.5
Amortization of deferred finance costs	13.5	13.2	16.0
Other notes payable	35.1	43.6	29.8
	387.4	384.2	402.9
Less capitalized interest	(3.3)	(1.4)	(1.7)
	$ 384.1	$ 382.8	$ 401.2

At year-end 1990 the Company had debt subject to interest rate changes of $427 million, principally in Canada. In order to reduce exposure to increasing interest rates, Safeway in 1990 entered into two interest rate collar agreements totaling $129 million. The agreements limit interest rates to between approximately 10% and 15% and expire in 1992.

Note G – Redeemable Preferred Stock

Authorized preferred stock consists of 10 million shares of which 5 million shares are designated as adjustable rate cumulative exchangeable preferred stock ("Redeemable Preferred Stock"). In 1986 the Company sold 450,000 shares of Redeemable Preferred Stock for $45 million and subsequently issued an additional 96,000 shares to satisfy dividend requirements. In April 1988, the Company redeemed all outstanding Redeemable Preferred Stock for $57.1 million, including a $1.1 million redemption premium and $1.4 million of accrued dividends. The Redeemable Preferred Stock had quarterly dividend rates ranging from 16.66% to 17.66% in 1988 through the redemption date. There was no Redeemable Preferred Stock outstanding as of year-end 1990 and 1989.

Note H – Common Stock

Shares Authorized and Issued

Authorized common stock consists of 300 million shares of $0.01 par value. Common stock outstanding at year-end 1990 and 1989 was 79.3 million and 67.7 million shares, respectively.

The Common Stock Partnerships, which are two limited partnerships formed by KKR, owned 65 million shares of the Company's common stock at year-end 1990 and 1989. The general partner of each of the Common Stock Partnerships is KKR Associates, a New York limited partnership of which the general partners of KKR are the general partners. KKR Associates has sole voting and investment power with respect to such shares. During the second quarter of 1990 in an initial public offering, the Company sold 11.5 million shares of common stock, including 1.5 million overallotment shares, at $11.25 per share. Net proceeds were approximately $120 million. The remaining shares are owned primarily by officers of the Company. Most of these shares were purchased under subscription agreements with notes requiring periodic principal and interest payments. No shares were sold by either KKR or the Company officers in connection with the initial public offering. The common stock and warrants to purchase approximately 4.6 million shares of common stock are listed on the New York Stock Exchange.

Common stock issued to certain Company officers is restricted as to transferability and, upon termination of employment, may be repurchased at the option of the Company.

Options to Purchase Common Stock

Under the Company's stock option plan, the Company may grant incentive and non-qualified options to purchase up to 14 million shares of common stock at an exercise price determined by the Compensation and Stock Option Committee of the Board of Directors. Vested options are exercisable in part or in full at any time prior to the expiration date of ten to fifteen years from the date of the grant. The stock option plan prohibits the transfer of options.

Note H – Common Stock *(continued)*

Activity in the stock option plan for the three-year period ended December 29, 1990 was as follows:

	Options	Option Price
Outstanding, year-end 1987	4,690,000	$2.00
1988 Activity:		
Granted	1,175,000	2.00
Cancelled	(237,500)	2.00
Exercised	(218,722)	2.00
Outstanding, year-end 1988	5,408,778	2.00
1989 Activity:		
Granted	1,600,000	2.00
Cancelled	(122,500)	2.00
Exercised	(13,800)	2.00
Outstanding, year-end 1989	6,872,478	2.00
1990 Activity:		
Granted	4,864,650	10.875-13.875
Cancelled	(34,700)	12.875
Exercised	(76,500)	2.00
Outstanding, year-end 1990	11,625,928	2.00-13.875
Exercisable, year-end 1990	6,881,978	2.00-12.00

Certain Company officers paid $0.80 per share toward the exercise price for 86,000 and 900,000 options granted in 1990 and 1989, respectively. Of those options exercisable at year-end 1990, 86,000 were exercisable at $12.00 per share and the remainder were exercisable at $2.00 per share.

Warrants to Purchase Common Stock

In connection with the Acquisition, the Company issued Merger Warrants to purchase common stock and Junior Subordinated Debentures in exchange for 27% of Predecessor's common stock. Each Merger Warrant represents the right to purchase 0.279 shares of the Company's common stock for $1.052 per warrant. In order to purchase a whole share of common stock a holder must exercise 3.584 warrants and pay an aggregate exercise price of $3.7691. During 1990, 121,937 Merger Warrants representing 34,020 shares of common stock were exercised. The Merger Warrants expire on November 24, 1996.

Warrants (the "SSI Warrants") to purchase 13.9 million shares of the Company's common stock at $2.00 per share were sold in 1986 to SSI Equity Associates, L.P., a limited partnership (the "SSI Partnership"), for net proceeds of $2.1 million. The SSI Warrants are exercisable through November 15, 2001. SSI Partners, L.P., an affiliate of KKR, is the general partner of the SSI Partnership.

Outstanding common stock and the effect of options and warrants at year-end 1990 were as follows:

	Shares (in thousands)	Potential Proceeds from Exercise (in millions)
Common stock outstanding	79,288	
Options to purchase common stock	11,626	$ 75.7
Merger Warrants	4,608	17.4
SSI Warrants	13,928	27.9
	109,450	$ 121.0

Note I – Taxes on Income

The components of income tax benefit (expense) included in the consolidated statements of income were as follows (in millions):

	1990	1989	1988
Current:			
Federal	$ (82.4)	$ (6.3)	$ (16.6)
State	(8.3)	(3.8)	(4.8)
Foreign	(52.5)	(69.9)	(51.0)
	(143.2)	(80.0)	(72.4)
Deferred:			
Federal	30.6	18.6	32.6
State	(1.4)	3.8	2.1
Foreign	6.4	(33.9)	3.6
	35.6	(11.5)	38.3
Total income tax expense	$ (107.6)	$ (91.5)	$ (34.1)

Note I – Taxes on Income *(continued)*

A reconciliation of the provision for income taxes at the U.S. federal statutory income tax rate to the Company's income tax expense is as follows (in millions, except percentages):

	1990	1989	1988
Statutory rate	34%	34%	34%
Income tax expense using federal statutory rate	$ (66.2)	$ (31.9)	$ (22.2)
Withholding tax on undistributed Canadian earnings	(7.4)	(46.0)	–
Difference between statutory rate and foreign effective rate	(5.5)	(12.7)	(9.4)
Deferred tax adjustment	(14.5)	10.6	15.0
Taxes on repatriated foreign earnings	(13.1)	(8.9)	(13.0)
Nondeductible amortization	(2.4)	(2.4)	(2.4)
Unrecognized tax (benefit) expense of affiliate's (losses) income	8.6	(1.7)	–
U.S. investment tax credit recapture	(0.1)	(1.4)	(1.5)
State taxes on income less federal benefit	(6.4)	–	(1.8)
Other, net	(0.6)	2.9	1.2
Income tax expense	$ (107.6)	$ (91.5)	$ (34.1)

Prior to the fourth quarter of 1989, the Company considered the undistributed earnings of its foreign (primarily Canadian) subsidiaries to be permanently reinvested in those subsidiaries. Accordingly, the Company had not provided for taxes that would be payable upon repatriation of such undistributed earnings. The Company decided to repatriate $460 million in undistributed earnings from its Canadian subsidiaries in the form of an intercompany dividend in 1990, resulting in the recognition of a $46 million income tax expense in the fourth quarter of 1989.

Note J – Employee Pension and Benefit Plans

U.S. and Canadian Retirement Plans (the "Plans")

The Company maintains defined benefit, non-contributory pension plans for substantially all of its U.S. and Canadian employees not participating in multi-employer pension plans. Benefits are generally based upon years of service, age at retirement date and employee's compensation during the last years of employment. The Company's funding policy is to contribute annually the amount necessary to satisfy the statutory funding standards. Through year-end 1990, the assets of the Plans have exceeded the actuarially determined liabilities of the Plans by such amounts that the Plans were considered fully funded for purposes of contribution requirements. Accordingly, no Company contributions were made to the Plans during the last three years. Assets of the Plans are primarily comprised of interest bearing securities.

Actuarial assumptions used to determine 1990, 1989 and 1988 net pension income and year-end plan status were as follows:

Weighted average assumed discount rate used to determine the projected benefit obligation	8.5%
Assumed long-term rate of return on Plan assets	8.0%

The assumed rate of compensation increase used to calculate the projected benefit obligation was 7.0% in 1990 and 7.5% in 1989 and 1988.

Net pension plan income consisted of the following (in millions):

	1990	1989	1988
Return on plan assets:			
Actual return, gain	$ 47.2	$ 99.5	$ 56.7
Deferred loss (gain)	22.8	(34.4)	7.1
Actuarial assumed return	70.0	65.1	63.8
Service cost	(29.0)	(26.1)	(23.6)
Interest cost on projected benefit obligations	(37.8)	(31.8)	(29.7)
Net amortization	(3.0)	(1.4)	(1.8)
Gains recognized on partial settlements and curtailments of obligations	0.7	0.7	–
Net pension plan income recognized in consolidated statements of income	$ 0.9	$ 6.5	$ 8.7

The funded status of the plans at year-end 1990 and 1989 were as follows (in millions):

	1990	1989
Actuarially determined present value of:		
Vested benefit obligations	$ 392.5	$ 370.0
Nonvested benefit obligations	3.5	5.1
Accumulated benefit obligations	396.0	375.1
Additional amounts related to projected compensation increases	100.0	72.3
Projected benefit obligations	496.0	447.4
Fair value of assets at year-end	901.8	897.8
Fair value of assets in excess of projected benefit obligations	405.8	450.4
Adjustment for difference in book and tax basis of assets	(185.7)	(188.8)
Unamortized prior service costs resulting from improved Plan benefits	54.1	56.0
Unrecognized net loss (gain) from actuarial experience which has not been recognized in the consolidated financial statements	30.4	(13.9)
Prepaid pension costs	$ 304.6	$ 303.7

Note J – Employee Pension and Benefit Plans *(continued)*

Multi-employer Pension Plans

The Company participates in various multi-employer pension plans, covering virtually all Company employees not covered under the Company's non-contributory pension plans, pursuant to agreements between the Company and employee bargaining units who are members of such plans. These plans are generally defined benefit plans; however, in many cases, specific benefit levels are not negotiated with, or known by the employer-contributors. Contributions of $73 million, $78 million and $91 million were made and charged to income in 1990, 1989 and 1988, respectively.

Under U.S. legislation regarding such pension plans, a Company is required to continue funding its proportionate share of a plan's unfunded vested benefits in the event of withdrawal (as defined by the legislation) from a plan or plan termination. The Company participates in a number of these pension plans and the potential obligation as a participant in these plans may be significant. The information required to determine the total amount of this contingent obligation, as well as the total amount of accumulated benefits and net assets of such plans, is not readily available. During 1988 and 1987 the Company sold certain operations. In most cases the party acquiring the operations agreed to continue making contributions to the plans, thus relieving the Company of the obligations related to those sold operations. Whether such sales could result in withdrawal under ERISA and if so, whether such withdrawals could result in liability to the Company is not determinable at this time.

Profit-sharing Plans

The Company has profit-sharing plans for eligible U.S. and Canadian employees. Amounts contributed under the plans are paid to employees upon termination from the Company. No contributions have been made to the plans in the last three years.

Senior Executive Supplemental Benefit Plan

The Senior Executive Supplemental Benefit Plan (the "SESBP") provides death benefits and supplemental income payments during retirement for senior executives. The Company has purchased life insurance to fund obligations of the SESBP. The Company recognized expense, including the cost of the life insurance, of $6.2 million in 1990, $5.1 million in 1989 and $3.9 million in 1988. The aggregate projected benefit obligation of the SESBP reflected in the consolidated financial statements was approximately $32.2 million at year-end 1990 and $27.7 million at year-end 1989.

Post-retirement benefits other than pensions

In addition to pension, profit sharing and SESBP benefits, the Company provides certain health care and life insurance benefits for retired employees. The cost of providing these benefits is recognized as claims are paid. Expenses were $4.1 million, $4.3 million and $2.1 million for 1990, 1989 and 1988, respectively.

Statement of Financial Accounting Standards No. 106 "Employers' Accounting for Post-retirement Benefits Other Than Pensions" was issued in December 1990 and must be implemented by 1993. The statement requires accrual of the expected cost of such benefits during employee service periods. Based on preliminary calculations in accordance with the statement, the present value of such benefit obligations through year-end 1990 (the "Transition Obligation") was approximately $34 million. The statement allows amortization of the Transition Obligation over the greater of 20 years or the average remaining service period of active plan participants. Using a 20-year amortization period for the Transition Obligation, the net periodic post-retirement cost for 1990 would have approximated $6 million. The Company has not determined the method or timing for implementation of the statement.

Note K – Contingent Liabilities

In July 1988 there was a major fire at the Company's dry grocery warehouse in Richmond, California. The Company's loss as a result of the fire damage to its property was substantially covered by insurance. As of February 12, 1991, there were lawsuits against the Company pending in the California Superior Court for Alameda County on behalf of 7,100 adult plaintiffs, and claims (some of which have not yet been filed in court) on behalf of approximately 7,000 minors. Attorneys representing some of the plaintiffs have stated that claims on behalf of still additional minors may be filed but it is not presently possible to determine the number of such additional lawsuits which will in fact be filed on behalf of such minors. The lawsuits, which have been coordinated for discovery, seek recovery for personal injury and property damages as well as punitive damages. While no persons died or were injured in the fire, 18 suits for wrongful deaths are included in the coordinated action and are based on the ground that pre-existing health conditions of such persons were aggravated by smoke, ash or embers from the fire. The complaints filed on behalf of the plaintiffs do not state the individual or aggregate amounts of compensatory and punitive damages being sought, but attorneys representing the largest group of plaintiffs have filed a statement of damages pursuant to California law seeking general damages in the amount of $700 million, special damages in an amount not specified and punitive damages in an amount to be determined at trial. In addition to these lawsuits and claims, through February 12, 1991, the Company, for an aggregate cost of approximately $39 million has settled approximately 105,000 additional claims for property damage and/or personal injury in connection with the fire. Counsel for certain of the plaintiffs has asserted that a substantial number of these settlements are void because of fraud, absence of court approval for settlements with minor persons, or because settling claimants were not represented by counsel. It is impossible to ascertain the number of settlements which might be asserted to be void on these grounds and the number of additional lawsuits which might be pursued if such settlements were determined by a court of competent jurisdiction to be void. The average cost of settling or otherwise disposing of pending lawsuits and any additional lawsuits which result from allegedly void settlements could be substantially greater than settlements effected to date. The Company does not believe that the aggregate liability for all settled and unsettled claims will exceed the limit of the insurance policies which the Company had in effect as of the date of the fire. Any punitive damages which might be awarded to a plaintiff at trial are not covered by such policies. Discovery is in progress in these actions and the Company intends to defend this matter vigorously.

Note K – Contingent Liabilities *(continued)*

The Company's primary insurance carrier has asserted that its liability policies do not cover third party property damage and personal injury claims that have arisen out of the fire on the ground that smoke, ash and embers generated by the fire are "pollution" which is excluded from coverage under the policies. Similar assertions have been made by the other carriers whose policies provide additional layers of excess liability coverage with respect to this occurrence. The Company and its primary carrier have agreed that the carrier will provide funding for the claims settled to date as well as all additional claims up to the limit of its policies. The carrier has provided an aggregate of $34 million in funding to settle claims to date. The Company has filed an action against its insurance carriers in California Superior Court for San Francisco County seeking a judicial determination that such policies provide coverage for all third party property damage and personal injury claims that have arisen out of the fire. If the Company were not to prevail in this action, it would be required to reimburse the insurance carrier for all amounts advanced to settle such claims, including the $34 million provided for settlement to date, together with interest, and would be responsible for the unsettled claims. The Company has named its insurance broker in the litigation, seeking damages from the broker equal to the loss the Company would suffer as a result of any judicial determination that the Company's carriers were not obligated to provide coverage for the claims. The carriers have filed a motion for summary judgment on the issue of coverage. The court has ordered the Company to file its own motion for summary judgment on the issue of coverage, and such motions will be decided concurrently. Discovery is in progress and the Company intends to pursue this matter vigorously.

There are also pending against the Company various claims and lawsuits arising in the normal course of business, some of which seek damages and other relief which, if granted, would require very large expenditures. It is management's opinion that although the amount of liability with respect to all of the above matters cannot be ascertained at this time, any resulting liability will not have a material adverse effect on the Company's consolidated financial position.

Note L – Commitments

The Company has commitments under contracts for the purchase of property and equipment and for the construction of buildings. Portions of such contracts not completed at year-end are not reflected in the consolidated financial statements. These unrecorded commitments amounted to approximately $115.5 million at year-end 1990.

Note M – Investment in Affiliate

In August 1988, the Company received approximately 30% of the outstanding common stock of The Vons Companies, Inc. in connection with the sale of the Company's southern California operations. Through December 1989 the Company purchased in open market transactions an additional 1,883,200 shares of Vons' common stock resulting in total holdings of 13,551,000 shares, or approximately 35% of total Vons' shares outstanding. The Company and certain of its affiliates have entered into a standstill agreement with Vons which expires in 1993, which generally limits the Company's ability to buy or sell Vons common stock. Income from Safeway's equity investment in Vons was $18.3 million in 1990 compared to losses of $8.6 million and $8.7 million in 1989 and 1988, respectively. As of year-end 1990, the Company's recorded investment was $112.9 million with an aggregate quoted market value of $296.4 million on the New York Stock Exchange. The Company records its equity in Vons' net income on a one quarter delay basis.

Summarized financial information from Vons' unaudited 1990 Third Quarter Form 10-Q is as follows (in millions):

Financial Position	October 7 1990	December 31 1989
Current assets	$ 365	$ 419
Property and capital leases, net	700	646
Other assets	585	590
Total assets	$ 1,650	$ 1,655
Current liabilities	$ 490	$ 511
Long-term obligations	917	954
Shareholders' equity	243	190
Total liabilities and shareholders' equity	$ 1,650	$ 1,655

	40 Weeks Ended	
Results of Operations	October 7 1990	October 8 1989
Sales	$ 4,072	$ 3,977
Cost of sales, and other expenses	4,019	4,005
Net income (loss)	$ 53	$ (28)

Included in Vons' net income for the 40 weeks ended October 7, 1990 is a tax benefit of $20.5 million reflecting the utilization of $59.1 million of net operating loss carryforwards. At October 7, 1990 Vons had $65.9 million of net operating loss carryforwards for financial statement purposes which could be utilized in future periods.

Note N – Related Party Transactions

KKR provides management, consulting and financial services to the Company for an annual fee. Such services include, but are not necessarily limited to, advice and assistance concerning any and all aspects of the operation, planning and financing of the Company. The payments for management fees, special services and reimbursement of expenses were $807,000, $655,000 and $592,000 in 1990, 1989 and 1988, respectively.

The Company holds an 80% interest in Property Development Associates ("PDA"), a partnership formed in 1987 with a Company controlled by KKR, to purchase, manage and dispose of certain Company facilities, primarily those which are no longer used in the retail grocery business. The accounts of PDA are consolidated with those of the Company and minority interest of $10.1 million is included in accrued claims and other liabilities in the accompanying consolidated balance sheet. During 1990, the Company completed the sale or transfer of 35 properties no longer used in its retail grocery business to PDA for an aggregate net purchase price of $5.6 million. Also during 1990, the Company paid PDA $2.1 million for reimbursement of expenses related to management and real estate services provided by PDA in connection with certain of the Company's properties no longer used in the retail grocery business. No gains or losses were recognized on these transactions.

Note O – Financial Information by Geographic Area

(in millions)	1990	1989	1988
United States:			
Sales	$ 11,172.8	$ 10,779.1	$ 10,307.6
Gross profit	3,051.8	2,826.0	2,626.0
Operating profit	407.6	340.0	278.1
Income (loss) before taxes	104.3	(22.3)	(46.4)
Net working capital (deficit)	41.1	(387.6)	(303.0)
Total assets	3,696.3	3,476.6	3,383.4
Net liabilities	(362.3)	(1,018.5)	(973.9)
Canada:			
Sales	$ 3,700.8	$ 3,545.5	$ 3,304.8
Gross profit	924.8	863.5	809.8
Operating profit	127.7	122.4	120.8
Income before taxes	90.4	116.3	111.7
Net working capital	161.8	172.7	153.3
Total assets	1,042.8	1,061.4	988.3
Net assets	178.9	629.6	605.5

Note P – Quarterly Information (unaudited)

(in millions, except per share amounts)	Year	Last 16 Weeks	Third 12 Weeks	Second 12 Weeks	First 12 Weeks
1990					
Sales	$ 14,873.6	$ 4,636.9	$ 3,465.6	$ 3,435.1	$ 3,336.0
Gross profit	3,976.6	1,249.3	933.5	921.8	872.0
Operating profit	535.3	163.8	127.6	132.3	111.6
Income before income taxes	194.7	56.5	48.4	53.8	36.0
Net income	87.1	27.7	20.8	23.6	15.0
Net income per common share and common share equivalent (primary and fully diluted)	$ 0.91	$ 0.28	$ 0.21	$ 0.25	$ 0.17
Price range, New York Stock Exchange	$ 10¾ to 16⅝	$ 10¾ to 14	$ 12⅜ to 16⅝	$ 11¾ to 12⅝	N/A
1989					
Sales	$ 14,324.6	$ 4,514.6	$ 3,312.0	$ 3,271.4	$ 3,226.6
Gross profit	3,689.5	1,169.5	860.4	841.1	818.5
Operating profit	462.4	139.3	111.5	105.9	105.7
Income before income taxes	94.0	35.4	24.2	16.1	18.3
Net income (loss) (Note 1)	2.5	(21.1)	7.1	7.7	8.8
Net income (loss) per common share and common share equivalent:					
Primary	$ 0.05	$ (0.23)	$ 0.09	$ 0.10	$ 0.12
Fully diluted	0.03	(0.23)	0.09	0.10	0.12

Note 1. Fourth quarter net income includes income tax expense of $46 million on the undistributed earnings of Canadian subsidiaries.

Consolidated Supplemental Financial Schedules

Safeway Inc. and Subsidiaries

Short-Term Borrowings

(dollars in millions)

Category of Aggregate Short-Term Borrowings	Balance at End of Period	Weighted Average Rate at End of Period	Maximum Amount Outstanding During the Period	Average Amount Outstanding During the Period (Note 1)	Weighted Average Interest Rate During the Period (Note 2)
1990					
Commercial paper	–	–	$ 133.0	$ 42.4	8.85%
Working Capital Credit Agreement (Note 3)	–	–	350.0	7.4	8.92
Money market facility	–	–	236.0	73.0	8.68
Bankers acceptances	–	–	50.0	18.2	8.83
1989					
Commercial paper	$ 102.0	8.99%	$ 231.5	$ 168.0	9.86%
Working Capital Credit Agreement	43.0	10.15	108.0	24.0	10.16
Money market facility	86.0	9.03	286.3	161.3	9.74
Bankers acceptances	40.0	8.63	40.0	21.5	9.40
1988					
Commercial paper	$ 122.5	9.74%	$ 205.0	$ 150.4	8.30%
Working Capital Credit Agreement	108.0	10.50	108.0	36.1	9.18
Money market facility	67.0	9.86	152.0	26.7	8.84

Note 1. Average amount outstanding during the period was computed by dividing the total of daily outstanding principal balances by the number of days in the fiscal period.

Note 2. Weighted average interest rate during the period was computed by dividing the actual short-term interest expense by the average amount outstanding during the period as described in Note 1.

Note 3. Prior to restructuring the Bank Agreements in June 1990, borrowings under the Working Capital Credit Agreement were short-term. Borrowings under the amended Working Capital Credit Agreement are long-term and excluded from this schedule.

Property, Plant and Equipment

(in millions) Classification	Balance at Beginning of Period	Additions at Cost	Retirements or Sales	Exchange Rate Effects	Other Changes Add (Deduct) (Note 1)	Balance at End of Period
1990						
Land	$ 240.8	$ 46.2	$ (2.2)	$ 0.1	$ 3.8	$ 288.7
Buildings	537.1	74.9	(5.4)	0.2	17.5	624.3
Leasehold Improvements	717.2	69.5	(11.3)	0.2	(6.5)	769.1
Fixtures and Equipment	1060.1	232.3	(19.6)	0.5	–	1,273.3
Property Under Capital Leases	341.2	3.3	(11.7)	–	(0.9)	331.9
	$ 2,896.4	$ 426.2	$ (50.2)	$ 1.0	$ 13.9	$ 3,287.3
1989						
Land	$ 194.5	$ 43.0	$ (11.0)	$ 1.4	$ 12.9	$ 240.8
Buildings	408.1	106.7	(8.4)	3.3	27.4	537.1
Leasehold Improvements	690.8	52.7	(12.3)	2.4	(16.4)	717.2
Fixtures and Equipment	893.1	177.6	(15.9)	5.9	(0.6)	1,060.1
Property Under Capital Leases	317.8	12.6	(5.5)	1.3	15.0	341.2
	$ 2,504.3	$ 392.6	$ (53.1)	$ 14.3	$ 38.3	$ 2,896.4
1988						
Land	$ 157.2	$ 46.3	$ (13.5)	$ 4.5		$ 194.5
Buildings	346.5	67.0	(14.3)	8.9		408.1
Leasehold Improvements	702.3	26.1	(45.5)	7.9		690.8
Fixtures and Equipment	735.9	145.8	(4.7)	16.1		893.1
Property Under Capital Leases	359.0	6.3	(51.7)	4.2		317.8
	$ 2,300.9	$ 291.5	$ (129.7)	$ 41.6		$ 2,504.3

Note 1. Amounts include reclassifications and transfers.

Accumulated Depreciation and Amortization of Property, Plant and Equipment

(in millions) Classification	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements or Sales	Exchange Rate Effects	Other Changes-Add (Deduct) (Note 1)	Balance at End of period
1990						
Buildings	$ 93.0	$ 41.8	$ (1.4)	$ 0.1	$ 6.8	$ 140.3
Leasehold Improvements	142.9	48.5	(2.7)	0.1	(2.0)	186.8
Fixtures and Equipment	411.7	149.4	(12.3)	0.3	–	549.1
Property Under Capital Leases	95.2	26.0	(6.2)	–	0.8	115.8
	$ 742.8	$ 265.7	$ (22.6)	$ 0.5	$ 5.6	$ 992.0
1989						
Buildings	$ 49.8	$ 36.3	$ (5.9)	$ 0.6	$ 12.2	$ 93.0
Leasehold Improvements	93.7	48.5	(2.0)	0.5	2.2	142.9
Fixtures and Equipment	281.9	135.3	(7.4)	2.4	(0.5)	411.7
Property Under Capital Leases	46.7	27.3	(3.6)	0.4	24.4	95.2
	$ 472.1	$ 247.4	$ (18.9)	$ 3.9	$ 38.3	$ 742.8
1988						
Buildings	$ 24.0	$ 26.2	$ (1.1)	$ 0.7		$ 49.8
Leasehold Improvements	45.9	50.8	(3.7)	0.7		93.7
Fixtures and Equipment	155.6	127.7	(5.9)	4.5		281.9
Property Under Capital Leases	54.7	32.4	(40.8)	0.4		46.7
	$ 280.2	$ 237.1	$ (51.5)	$ 6.3		$ 472.1

Note 1. Amounts include reclassifications and transfers.

Consolidated Supplemental Financial Schedules *(continued)*

Safeway Inc. and Subsidiaries

Computation of Earnings Per Common Share and Common Share Equivalent

(in millions, except per share amounts)	1990	1989		1988
		Fully Diluted	Primary	
Net income	$ 87.1	$ 2.5	$ 2.5	$ 31.2
Dividends on Redeemable Preferred Stock	–	–	–	(3.6)
Net income to common stockholders	87.1	2.5	2.5	27.6
Reduction of interest expense under the treasury stock method, net of tax	–	–	1.6	1.9
Net income to common stockholders under the treasury stock method	$ 87.1	$ 2.5	$ 4.1	$ 29.5
Weighted average common shares outstanding	75.3	67.6	67.6	67.6
Common share equivalents related to stock options and warrants	20.7	21.8	12.0	11.1
Weighted average common shares and common share equivalents	96.0	89.4	79.6	78.7
Common stock price used under the treasury stock method	$ 12.66	$ 16.00	$ 2.54	$ 2.00
Net income per common share and common share equivalent (Note 1)	$ 0.91	$ 0.03	$ 0.05	$ 0.38

Note 1. The amounts for primary and fully diluted income per common share and common share equivalent are the same for 1990 and 1988.

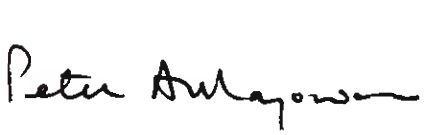
Management's Report

The consolidated financial statements of Safeway Inc. have been prepared in accordance with generally accepted accounting principles and necessarily include amounts that are based on management's best estimates and judgments. Management is responsible for the consistency, integrity and presentation of the data in these statements. Financial information elsewhere in this annual report is consistent with that in the financial statements.

To fulfill its responsibilities, management maintains comprehensive systems of internal controls designed to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with management's authorizations and are reflected accurately in the Company's records. The concept of reasonable assurance is based upon a recognition that the cost of the controls should not exceed the benefit derived. Management believes that its controls are reinforced by careful selection and training of qualified personnel, comprehensive written policies and procedures, and by an extensive program of internal audits.

The Audit Committee of the Board of Directors is comprised of outside directors and oversees the fulfillment by management of its responsibilities over internal controls and the preparation of financial statements. Internal and external auditors have direct access to the Board of Directors without the presence of management through regular meetings with the Committee to review audit plans and audit results.

The Company has engaged Deloitte & Touche, independent auditors, to conduct an audit of the Company's financial statements in accordance with generally accepted auditing standards. The report of Deloitte & Touche is presented on page 52.



Peter A. Magowan
Chairman, President
and Chief Executive Officer

Michael M. Pharr
Executive Vice President,
Chief Administrative Officer
and Chief Financial Officer

Deloitte & Touche

Independent Auditors' Report

The Board of Directors and Stockholders of Safeway Inc.:

We have audited the accompanying consolidated balance sheets of Safeway Inc. and subsidiaries as of December 29, 1990 and December 30, 1989, and the related consolidated statements of income, stockholders' equity (deficit) and cash flows for each of the three fiscal years in the period ended December 29, 1990. Our audits also comprehended the consolidated supplemental financial schedules of Safeway Inc. and subsidiaries as of December 29, 1990, and for each of the three fiscal years in the period then ended, listed on page 12. These financial statements and supplemental financial schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Safeway Inc. and subsidiaries at December 29, 1990 and December 30, 1989, and the results of their operations and their cash flows for each of the three fiscal years in the period ended December 29, 1990 in conformity with generally accepted accounting principles. Also, in our opinion, such consolidated supplemental financial schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information shown therein.

Deloitte & Touche

Oakland, California
February 12, 1991

Directors and Officers

Directors

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Chairman
and Chief Executive Officer
Pacific Telesis Group

James H. Greene, Jr.
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Kohlberg Kravis Roberts & Co.

Paul Hazen
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and Chief Operating Officer
Wells Fargo & Co.
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Kohlberg Kravis Roberts & Co.

Robert I. MacDonnell
General Partner
Kohlberg Kravis Roberts & Co.

Peter A. Magowan
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and Chief Executive Officer

George R. Roberts
General Partner
Kohlberg Kravis Roberts & Co.

Harry D. Sunderland
Vice Chairman

Michael T. Tokarz
Associate
Kohlberg Kravis Roberts & Co.

Executive Officers

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Chairman, President
and Chief Executive Officer

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Vice Chairman

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Chief Administrative Officer
and Chief Financial Officer

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Executive Vice President
Retail Regional Manager

E. Richard Jones
Executive Vice President
Marketing, Distribution,
Information Systems
and Supply Operations

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Executive Vice President;
Chairman, President
and Chief Executive Officer
Canada Safeway Limited

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Executive Vice President
Retail Regional Manager

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Senior Vice President
Distribution

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Senior Vice President
Public Affairs

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Systems Development

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Finance

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MIS Operations

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Bernat Rosner
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Secretary and General Counsel

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Director of Marketing

Walter J. Schoendorf
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Supply Operations

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Treasury

Ronald F. Zachary
Senior Vice President
Human Resources

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Vice President
Controller

George D. Marshall
Vice President
Industrial Relations

Richard A. Wilson
Vice President
Tax

Other Officers

Senior Vice Presidents – Retail

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Eastern Division Manager

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Denver Division Manager

Thomas C. Keller
Seattle Division Manager

Robert R. Taylor
Phoenix Division Manager

George D. Unti
Northern California Division Manager

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A. W. McDown
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Thomas J. DeMott
Ronald Giglio
Russell L. Jacobus
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Wayne Leader
Terrie Leaver
William W. Liedtke
William L. Morgan
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Gilbert A. Neff
John E. Nie
Ronald K. Parmelee
Rayburn D. Pearce
Diane Peck
Gary D. Smith
John M. Shepherd
David R. Weierman
James E. Whitticom

Foreign Subsidiary Operations

Canada Safeway Limited

Directors:

Robert H. Kinnie
Chairman, President
and Chief Executive Officer

John K. Jope
Senior Vice President
Vancouver Division Manager

Norman J. Leaf
Senior Vice President
Winnipeg Division Manager

Henry R. Rempel
Senior Vice President
Alberta Division Manager

Alexander R. Paton
Vice President
Chief Financial Officer

Douglas J. Adams
Secretary

Other Officers:

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Senior Vice President
Corporate Merchandising

Garnet Berg
Vice President
Retail Operations

Gordy K. Cannady
Vice President
Human Resources

Grant Hansen
Vice President
Retail Operations

Emil Krein
Vice President
Retail Operations

G. Alan McQuitty
Vice President
Construction and Design

Donald M. Monk
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James A. Waters
Vice President
Public Affairs

John Whyte
Vice President
In-Store Merchandising

Donald P. Wright
Vice President
Real Estate

Walter Urichuk
Vice President
Retail Operations

Lucerne Foods Limited (Canada)
Robert H. Kinnie
Chairman of the Board

Equity Investments

The Vons Companies, Inc.
Roger E. Stangeland
Chairman and Chief
Executive Officer

Casa Ley, S.A.
(Mexico)
Juan Manuel Ley Lopez
Director General

Thomas S. Magers
Safeway Management
Representative

Investor Information

Executive Offices

Mailing Address:
Safeway Inc.
Oakland, California 94660
415- 891-3000

Transfer Agent and Registrar

Bank of Boston
Mail Stop: 45-02-09
P.O. Box 644
Boston, Massachusetts
02102-0644
617-575-2900

Form 10-K

A copy of Safeway's 1990 Form 10-K may be obtained by writing to the Investor Relations Department at our executive offices, or by calling 415-891-3790

Independent Auditors

Deloitte & Touche
Oakland, California

Annual Meeting

The Annual Meeting of Stockholders will be held on April 18, 1991. A notice of the meeting, together with a proxy statement and a form of proxy, were mailed to stockholders with this annual report.

Stock Exchange Listing

The company's common stock is listed on the New York Stock Exchange under the trading symbol SWY.

Investor Inquiries

Communications regarding investor records, including changes of address or ownership and exchanges of common stock and warrants, should be directed to the company's transfer agent, Bank of Boston, at the address listed on the left. To inquire by phone, call 1-800-442-2001.

Investors, security analysts, members of the media and others should direct their financial inquiries to Melissa C. Plaisance, Director of Investor Relations, at our executive offices.

To request financial reports, please write to the Investor Relations Department or call 415-891-3790.

Exchange Agent

For information about exchanging common stock of Safeway Stores, Incorporated (Maryland) into warrants to purchase common stock of Safeway Inc. (Delaware), contact Bank of Boston at the address listed on the left or call 617-575-2700.

Trustees and Paying Agents

Security
11.75% Senior Subordinated Notes

Trustee
Harris Bank
111 West Monroe Street
P.O. Box 755
Chicago, Illinois 60690

Paying Agent
Security Pacific
Institutional Service Corp.
P.O. Box 7887, N5-2107
San Francisco, California 94120
415-995-2107

Security
12% Subordinated Debentures

Trustee
Norwest Bank
Corporate Trust
Norwest Center
6th & Marquette
Minneapolis, Minnesota
55479-0069

Paying Agent
Security Pacific
Institutional Service Corp.
P.O. Box 7887, N5-2107
San Francisco, California 94120
415-995-2107

Security
14.5% Debentures

Trustee
Bank of Boston
Corporate Trust Division
Mail Stop: 45-02-15
P.O. Box 1618
Boston, Massachusetts
02105-1618

Paying Agent
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Boston, Massachusetts 02105
1-800-882-6637

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